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**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

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COMMISSION  
WASHINGTON, D.C. 20554

In the Matter of )  
 )  
Implementation of Sections 309(j) ) PP Docket No. 93-253  
of the Communications Act )  
Competitive Bidding )

To: The Commission

**REQUEST FOR CLARIFICATION  
OF LEHMAN BROTHERS**

**STATEMENT OF INTEREST**

Lehman Brothers ("Lehman") is a leading investment banking firm that has raised private and public capital for businesses, including start-ups and completed transactions worldwide since the early Twentieth Century. With its experience, Lehman is intimately familiar the financial needs of businesses and, in particular, with the difficulties faced by entrepreneurs and small businesses in acquiring the necessary financing to achieve their goals. A number of businesses have sought Lehman's assistance in raising capital in anticipation of the upcoming 2 GHz Personal Communications Service ("Broadband PCS") auctions and the subsequent build-out of such systems. Many of these entities appear to qualify for the Federal Communications Commission's ("Commission") special measures available to "designated entities," as defined by the Commission. Lehman has

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therefore closely examined the Commission's Broadband PCS auction rules contained in this proceeding's Fifth Report and Order<sup>1</sup> to determine how to attract qualified investors for such interested designated entities. As a result, Lehman submits that certain rules adopted in the Fifth Report and Order, absent certain changes and clarifications proposed herein, could inadvertently impair the ability of designated entities to attract investment capital. Accordingly, Lehman has standing as an "interested person" for purposes of Section 1.429 of the Commission's Rules, 47 C.F.R. § 1.429(a).

## DISCUSSION

### I. Introduction

Lehman recognizes that the Commission has undertaken significant actions and expended considerable effort to increase the likelihood of successful participation by designated entities in the Broadband PCS auctions. However, Lehman submits that additional clarifications are required to ensure that such entities have access to the private and public capital markets necessary to build-out and operate their systems.

### II. Designated Entities Need a Post-Auction Capital Raising Mechanism

Lehman recognizes that the Commission must balance competing policies of restricting eligibility for designated entity preferences to bona fide

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<sup>1</sup> Fifth Report and Order, PP Docket No. 93-253, FCC No. 94-178, \_\_ FCC Rcd \_\_ (Adopted June 29, 1994).

entities and, on the other hand, providing sufficient flexibility to permit such entities to raise the capital they require to build-out and operate PCS networks. The result of a successful balance of such competing policy objectives should not, of course, result in any significant harm to bona fide designated entities. Lehman submits, however, that requirement contained in the Fifth Report and Order that the designated entity "control group"<sup>2</sup> maintain control of 25% of the equity for the duration of the license term ("25% equity rule") may cause significant harm to bona fide designated entities by unnecessarily restricting their ability to raise capital after the auction.

Although the existing auction preferences -- entrepreneurs' blocks, installment payments, tax certificate policy and bidding credits -- all help designated entities raise capital to competitively bid for Broadband PCS licenses, they are not sufficient to ensure that the designated entities will be able to meet their capital requirements to build-out their systems. Absent additional flexibility for designated entities to sell equity to raise capital, Lehman submits that the 25% equity rule may effectively bar designated entities from building-out their Broadband PCS systems. The failure of designated entity licensees to raise adequate

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<sup>2</sup> A control group, discussed infra, must consist of one or more individuals or entities that control the licensee or applicant and hold at least 25% of the equity and, for corporations, at least 50.1% of the voting stock, to qualify as a small business or an entrepreneur for purposes of the Commission's preferences. Fifth Report and Order at para. 115.

capital to build-out their systems could force them to transfer or forfeit their licenses. This could result in the failure of the federal government to achieve its objectives related to the establishment of the entrepreneurs' bands for PCS. Accordingly, Lehman submits that the public interest requires that the Commission clarify its 25% equity rule.

Lehman recommends the following two solutions to remedy this problem. First, for publicly traded companies, after the completion of the auction the Commission would permit public shareholders with less than 5% equity to be counted toward the control group's 25% equity threshold.<sup>3</sup> This proposal would permit control group equity to be diluted by such new shareholders, but not below a minimum equity level.<sup>4</sup> Therefore, Lehman submits that this proposal would provide publicly traded companies with the flexibility to raise capital to build-out their PCS systems while maintaining bona fide designated entity ownership and control.

Second, Lehman offers the following proposal to apply to designated entities generally. Qualified designated entities should be permitted to dilute their 25% or more equity interests in the following circumstances: (1) not earlier

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<sup>3</sup> This proposal would not affect the requirement that designated entities must maintain 50.1% control of the voting stock.

<sup>4</sup> As a minimum equity level for the publicly traded companies' control group, Lehman recommends 10%.

than one year after license grant, to dilute the control group equity to a total of not less than 20%, (2) not earlier than two years after license grant, to dilute the control group equity to a total of not less than 15%, and (3) not earlier than three years after license grant, to dilute the control group equity to a total of not less than 10%.<sup>5</sup> Lehman recommends that the equity dilutions should be staggered over a period of years, as opposed to all at once, to ensure that the waiver request is narrowly tailored to address the bona fide capital needs of qualified entities to build-out their systems.<sup>6</sup> Such a solution will provide designated entities with efficient access to the capital markets, thereby enhancing their competitive position.

Because the wireless communications industry is highly competitive, designated entities must have additional flexibility to raise capital during their license term -- particularly in the critical early years -- to successfully launch their Broadband PCS systems. If adopted, these proposals would provide a fertile regulatory environment in which nascent capital formations could grow into fully operational systems.

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<sup>5</sup> The percentage of control group equity of a designated entity control would not be permitted to drop below a floor of 10% after the third year.

<sup>6</sup> Lehman has recommended that the dilutions be permitted during the first three years of the license term to reflect the market-place reality that the majority of capital expenditures will be incurred during the early years to construct the network and fund start-up operating losses.

### III. The Existing Definition of a "Control Group" Requires Clarification

Under Section 24.720(k)(iv) of the Commission's Rules, 47 C.F.R. § 24.720(k) (iv) ("Clause (iv)"), a control group has the "right to receive dividends, profits and regular and liquidating distributions from the business in proportion to its interest in the total equity of the applicant or licensee." Lehman submits that a strict construction of Clause (iv) is likely to concern potential passive (i.e., non-control group) investors that are inclined to invest in designated entity Broadband PCS systems.

For example, consider a designated entity which meets the 25% equity rule by using a combination of cash constituting 5% of the total equity and options (essentially "sweat equity") constituting 20% of the total equity on a fully diluted basis. For purposes of a numerical example, assume that the entity raises \$75 million from passive investors so that the fully diluted market capitalization of the company is \$100 million. In such a case, the control group would contribute a nominal amount of cash ( \$5 million, which represents approximately 6.25% of the total invested capital and 5% of the total equity on a fully diluted basis) and would receive at-the-money options which represent 20% of the total equity on a fully diluted basis. Under this scenario, prior to the PCS auctions, the entity's tangible assets are mostly represented by invested capital (cash) (\$80 million).

If unexercised options are treated as equity interests for the purpose of meeting the 25% equity rule, then under a strict construction of Clause (iv), these same options may be treated as equity interests for the purpose of receiving distributions. Assuming the entity raised this capital prior to the auctions in anticipation of winning a substantial number of licenses, but is only marginally successful at the auctions, passive investors would likely want to receive a distribution of a substantial portion of their invested capital (cash) back (because there no longer exists a need for the funds) without liquidating the entity.<sup>7</sup> Based on a strict construction of Clause (iv), and using the same logic that was applied in determining the economic ownership or the "equity interest" of the entity, the control group could be entitled to 25% (i.e., \$20 million out of the \$80 million) of the distribution even though the control group had only contributed 6.25% (i.e., \$5 million out of the \$80 million) of the total invested capital, and was not in actual possession of 25% of the equity.

Accordingly, Lehman submits that the strict construction of Clause (iv) would provide a control group a perverse incentive to be only minimally successful in the auctions. Therefore, if the entity distributes most of its cash back to investors, then under a strict interpretation of the rules such a control group could be entitled to 25% of the total invested capital while only investing a

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<sup>7</sup> Liquidation of the entity would cause the imposition of penalties because the entity was partially successful in the auctions.

disproportionately small amount of cash and prior to gaining actual possession of the equity. Alternatively, if the business did not have the option of distributing the cash, it would inhibit the designated entity's ability to raise pre-auction capital.

To prevent such an event, the Commission should clarify Clause (iv) to prohibit the above-illustrated scenario. Lehman recommends that the Commission clarify its rule by merely including a requirement in Clause (iv) similar to the one in Clause (iii): the right to "receive dividends, profits and regular and liquidating distributions" should be solely determined by the actual possession of the equity.

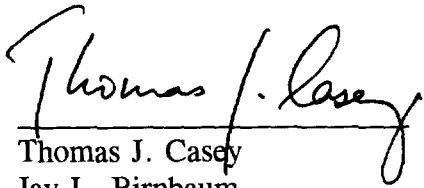


## CONCLUSION

For the aforementioned reasons, Lehman Brothers respectfully requests that the Commission clarify its 25% equity rule and clarify Section 24.720(k), to provide bona fide designated entities with sufficient flexibility raise capital to participate in the provision of Broadband PCS service.

Respectfully submitted by:

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